Vicom Multimedia Inc.

1996 ANNUAL REPORT

Mission Statement

To excel in a global marketplace as a profitable and innovative developer of multimedia software, products and services, fostering high performance, integrity and uncompromising customer service.

Table of contents

President's Message:

Dan Chugg, President & CEO

"In the brief time we spent with Nereus, we were impressed by its breadth. Vicom, which has more than a decade of experience with multimedia creation and production, has put a lot of thought into making an extremely comprehensive package.
... it promises a level of collaboration, project management and automation that is not provided by today's desktop multimedia tools."

(Seybold Report on Publishing Systems, Vol. 26, No. 8, December 30, 1996)

The Transition from Service to Software

Since going public in 1994, Vicom Multimedia Inc. has been shifting from a service to a software provider. While our service history will continue to provide invaluable experience, validation and support, the increased financial return that our shareholders expect will come from the gross margins of software sales.

In this fiscal year, revenues from product sales have increased by 33 percent. This increase in product revenue and its attendant higher gross margins have offset the effect of lower margins in the Edmonton service division resulting from a tighter market in the Edmonton area. Vicom anticipates that as much as 50 percent of 1997 revenues will come from product sales, consequently increasing gross margins next year.

Vicom is well financed

"Vicom has a tiger by the tail; Nereus™ is as powerful a product as has been introduced since the browser. Just as Andreessen's browser opened publishing of HTML on the web, Nereus™ will open up fifty other media types to being published on the web."

Alex Lightman,, President
Internet Hollyworlds, Inc.

"As multimedia content becomes a standard component in publishing and applications, the need for an architected production system is obvious."

Bob Gill
Gartner Group, Inc.

(see full review at Vicom's website www.vicom.ca, Investor Relations page)

The Unveiling of a Beast—
The Nereus™ Multimedia Publishing System

nereus™ was not just a good idea. Its creation, based on Vicom's considerable experience, was to solve the difficulties we encountered in producing multimedia using existing technology. The results speak for themselves.

In 1996, Vicom launched Version 1.2 of nereus™, a comprehensive, high-end multimedia publishing system. The money raised by the Special Warrant Issue provided the means for us to meet our development and market readiness. Today, entering 1997, Vicom is well financed and positioned to dominate the rapidly emerging multimedia on-line marketplace.

Transforming Our Future

Nereus was a sea god of Greek mythology endowed with the power of transformation. What better name for a technology that plays a central role in the transformation of Vicom Multimedia from a service to a software provider? The nereus™ technology also has the potential to transform the world of multimedia and, in so doing, provide Vicom with the potential for exponential growth.

Broad Market Potential

Human beings are multi-sensory in that they experience the world, and learn about it, through their senses—the eyes, ears, hands, nose.... And although humans also vary considerably in interpretation of these senses, they all have one thing in common: the more control over the learning experience, the better the outcome.

Interactive multimedia arose to meet the need to effectively match information presentation to learners' preferences. The results are well established. Interactive multimedia enables people to learn faster, retain knowledge longer, and apply it better. With results such as these, any organization that needs to train, communicate, educate, market, or simply inform, will sooner or later use interactive multimedia.

Overcoming the Barriers

If it's so great, why isn't everyone using it now? In a word: cost. Cost in terms of dollars, time, human resources, and infrastructure to create, deliver, update, manage, and convert both the content and mind set of an organization.

Much like Henry Ford's factories made automobiles affordable, nereus ™ makes multimedia affordable. The turn of the century process of building cars one at a time is akin to today's approach to multimedia production. nereus ™ is a revolutionary multimedia factory that will usher in the new era of multimedia.

"Vicom's experience in developing interactive training programs coupled with Sencore's 40 years of experience in providing innovative solutions to the service industry's needs will result in products that will revolutionize the consumer electronics repair industry. Providing the training and information needed to service consumer electronics along with our test instrumentation offering will expand our presence in the service industry and further solidify our position."

George Gonos,
Marketing Manager
Sencore, Inc.

aggressive marketing and sales

"Vicom is a vital part of the growing market for video technology. Our high-performance, scaleable Oracle® Video Server provides the server engine for Vicom's Nereus™ architecture. Companies can now take advantage of reduced multimedia development, management and delivery times and costs to build powerful enterprise solutions. We are pleased to be partnering with organizations like Vicom that provide specific application solutions for Oracle® Universal Server technology."

Mark Porter,
Oracle's Vice President
Media Server Development

Timing and Convergence

It is an auspicious time for multimedia. Just as cars without roadways stand still, multimedia without bandwidth is impotent.

For years, the information era has focused on "convergence". Telephones, computers, television, and software are converging into a single standard, necessitating information highways capable of supporting the development of this industry. The Internet was the first highway to demonstrate the power of this convergence, but the Internet can now be compared to the first ruts carved across the countryside. The next generation of convergence will introduce the superhighways required to carry the information vehicles of tomorrow. nēreus™ is the first factory to create those vehicles.

1997—Establishing a Presence

In late 1996, Vicom launched an aggressive marketing and sales campaign, to be intensified during 1997. The Company is concentrating on the specific vertical markets best suited and ready to adopt our technology, and has targeted the markets of defense, aerospace, educational publishing, corporate training, infotainment, and high-end web creation. Vicom is establishing VAR channels world wide, and has struck strategic alliances with industry giants like Oracle Corporation. We are adding to our sales force, and will establish sales and marketing operations in the US.

The focus for 1997 is to give nēreus™ a presence; in 1998, the focus will be to elevate it to a dominating force.

Corporate Restructuring—Agility and Focus

In the world of information technology, change is a way of life. In response to market pressures, Vicom's Smart Cata/og™ division centered its attention on the most rapidly developing electronic commerce marketplace, the petrochemical industry. The merger with DataCat joined two complementary technologies under a new management team. Instead of operating as one of four divisions, Smart Cata/og™, as a product of DataCat, will receive renewed energy and focus within a company whose sole purpose is to be dominant in the emerging world of electronic commerce.

"DataCat has an extraordinary opportunity to focus on solutions for some of the hottest themes in business today—applied chain management, business process improvement, electronic commerce and the Internet. With this kind of market potential, our prospects are excellent for tremendous growth in the months and years ahead."

Rick Hahn
DataCat President

SAFE-T-Disc™ also built on its continuing success, demonstrated by significant sales to the Building Industry Association (BIA) of the State of Hawaii and the creation of a new module for the safety program to meet the training requirements of the heavy oil industry. Unrelenting efforts with our partners for distribution of this product indicate a growing interest in technology-based safety training. Vicom continues to explore additional distribution options.

"The recent and extensive changes in the occupational safety and health standards for the US Construction Industry makes smaller business vulnerable in difficult economic times. The need for a safety training program including the use of the the state-of-the-art Vicom SAFE-T-Disc™, will be essential to keeping businesses profitable and, in some cases, in business."

Edmund Aczon
1997 BIA President

While both products will continue to generate revenue, Vicom remains committed to re-focusing our energies and resources.

Vicom, strong and healthy

"Your outstanding achievement is a reflection of the hard work and dedication that you and your employees have put into building a successful business."

Cheryl Knebel, President,
Alberta Chamber of Commerce.

Strong, Growing, and Focused

While restructuring and market readiness took its toll during 1996, Vicom remains strong and healthy in human and financial resources. The Company grew by more than 20 percent in 1996, and is positioned for accelerated growth during 1997 and beyond.

The true strength that resulted from 1996 is a company-wide focus. Supported by the expertise accumulated over 18 years, Vicom maintains an unprecedented clarity of purpose and focus—nēreus™ is destined to become the world standard and benchmark for multimedia.

Multimedia continues to demonstrate its power and potential. The April, 1996 Gartner Group report stated, "…multimedia truly is "for real" in business applications; it is not just fun and games."

With 90 percent of the Fortune 1000 companies deploying intranets capable of using media-rich multimedia, Vicom's nēreus™ remains the only comprehensive tool set designed to manage multimedia over these networks. We remain confident that we are a valuable investment for our shareholders.

It Just Keeps On Going

Vicom's service business can be likened to the television advertisement for batteries—it just keeps going and going. Our service business continually leads the way in applying technology to solve client training and communications needs —our mature service divisions remain solid. The expertise within the media production centres provides the backbone of the organization and the foundation for nēreus™. In 1997, both the Edmonton and Calgary media production centres will begin to realize the competitive advantages of utilizing our core technology to fuel significant growth.

"Vicom completed a major training project for Shell, on budget and within very tight timelines. It was great to deal with an organization that showed so much focus, enthusiasm and competence. Thanks for helping us better train our retailers!"

Jim Hubbard
Shell Canada
Calgary

Vicom wins Business Distinction Award

While nēreus™ will provide our production centres with a technological advantage, the real competitive advantage they enjoy is, in a word, service. This was recognized by the Alberta Business Awards of Distinction at their annual dinner when Vicom was awarded the 1997 Business Service Award of Distinction. Our success and achievements have been built on an uncompromising commitment to customer satisfaction. This same commitment will be an integral part of our emerging software business. The lessons learned in the past can help pave the road to our future.

"Our multimedia environmental awareness training program is a high quality product that we are very proud of. Vicom staff are helpful high performers who ensured our program's success — in fact, we are now marketing it outside our company."

Allan Hantelmann
Edmonton Power (Epcor)

Management Discussion and Analysis of Financial Condition and Results of Operations

Management has prepared the following discussion as a review of the Company's operating results and financial condition based on Canadian generally accepted accounting principles. It should be read in conjunction with the Company's 1997 audited consolidated financial statements, including the notes thereto.

General

The Company focused on the launch of the Nereus™ multimedia publishing system this year, and raised nearly $9,500,000 in a special warrant offering last summer largely to support that effort. Much of the latter half of the year was spent readying the product for launch at COMDEX, the world's largest computer products show. As the product neared completion, the Company used a portion of the warrant offering proceeds to create infrastructure for the anticipated growth in fiscal 1998. The current year loss is attributable to the marketing and sales effort undertaken to launch the Nereus™ product at COMDEX, subsequent marketing efforts, continued research and development, as well as sales performance below expectations in areas as noted below.

Results of Operations

Revenue and gross profit

Revenue and gross profit results for 1997 reflect the Company's transition from a service-based business to a service and software product based enterprise. Revenues are up 19% from last year, totalling $6,008,000. Service revenues increased by 5% to $4,716,000, while product sales increased by 121% to $1,292,000. Gross margins on service revenue are down 4% from last year to 39%, while margins on software products increased 3% to 75%.

We did not achieve our targeted revenues for fiscal 1997. The shortfall was in product sales, where anticipated growth did not occur. The lack of growth was largely due to the timing of overall market acceptance of electronic commerce, as well as computer-based training in the construction industry.

Product Revenue

Smart Cata/og™

Smart Cata/og™ is a multimedia catalogue creation software product that incorporates Electronic Data Interchange (EDI) to facilitate ordering and invoicing. This enabling software integrates full colour images, detailed text, audio, video, pricing, and a purchase order database which can operate across networks, the Internet, and on CD-ROM.

1996 was to be the year of electronic commerce according to industry pundits such as The Gartner Group. Many predictions had been made about this market. Vicom believed this was an area of tremendous growth opportunity, and anticipated growth in this area corresponding to the large rise in this market. Later in the year, industry experts revised their forecast for this market to 1998 or later. This lack of market readiness for the Smart Cata/og™ software was a significant factor in the Company not achieving its revenue objectives.

It was for this reason, in part, that the Company sold its Smart Cata/og™ software to DataCat International, Inc., in exchange for an initial 50% of this company's shares (see Note 3 to the consolidated financial statements).

DataCat has "expert" software that categorizes historical data at a very competitive cost relative to other alternatives. Data structuring and categorization is a necessary precursor to electronic commerce.

DataCat has been awarded the contract to run the data centre for the American Petroleum Institute (API), whose objective is to set a common material identification standard for all the supplies and capital equipment used in the petrochemical industry. This industry is seen by many as the leader in the shift to electronic commerce.

DataCat, by virtue of its association with the API, is well poised to be a major service provider of data mining and structuring to the petrochemical industry. Their plans are to incorporate Smart Cata/og™ into their solution model. Once a strong foothold is achieved in this sector, it will allow DataCat to cross industry lines and attempt inroads into other industry sectors.

SAFE-T-Disc™

SAFE-T-Disc™ is an interactive multimedia health and safety training system for the construction industry, using full screen video, graphics, and comprehensive testing to validate learning. Although we had a few successes this year, most notably an agreement with the Building Industry Association of Hawaii, SAFE-T-Disc™ did not perform as well as expected.

Last year we outlined our plans for SAFE-T-Disc™ with the National Center for Construction Education and Research (NCCER), and their plans to move forward with training centres across the US. The plan for these centres was delayed for approximately one year because of a restructuring at NCCER. We are still pursuing this method of delivering safety training to the US construction industry, but are also seeking out other alternatives for the US business.

A number of other states and Canadian provinces are also evaluating SAFE-T-Disc™ and its comprehensive construction safety training system; a number of organizations have expressed interest in distributing the product.

nereus™ and TekDisc™

Fiscal 1997 marked the first sale of the Nereus™ technology, with the sale of TekDisc™ for $750,000 plus future royalties on all TekDisc™ revenues generated. We also sold the first multimedia application for educational courseware created using the Nereus™ system. This project led to other projects shortly after year-end. These projects include another educational application and a "just-in-time" corporate training application. We are now gearing up all our sites to take advantage of the Nereus™ system to further enhance our revenue base.

Service Revenue

Service revenue showed a small growth pattern, growing at 5% over last year. This growth came despite a tight Edmonton market, from which approximately 50% of our service revenue traditionally has come. This tight market resulted in service revenue margins dropping by 4% overall.

While Edmonton market conditions remain very competitive, it is the Company's belief that its service margins should increase as a result of the use of the Nereus™ system. This increase will be achieved after service production centres are fully trained to use the Nereus™ system.

Expenses

This portion of the income statement demonstrates most clearly the shift from a service-oriented business to a software product business. Overall, the increase in expenses was approximately 20% from $4,815,000 to $5,802,000. However, there were marked differences in the areas of increase. The increases in expenditures in all areas, other than research and development, reflect the fact that the Company has moved from research and development of software to commercialization of the flagship software product.

General and administration

The following table sets out the gross and net general and administration costs for the fiscal years ended January 31, 1997 and 1996.

($ 000s)	1997	1996
Total G & A expenses	$ 2,008	$ 1,531
Allocated to R & D	268	601
Net G & A expenses	$ 1,740	$ 931

General and administrative expenses increased by 31% over 1996 levels to $2,008,000. The most significant increase occurred in professional fees. These include legal fees on registration of patents and copyrights, search fees for key personnel, legal fees regarding the merger with DataCat, and consulting fees for MIS strategy. Generally, the balance of the increase results from increasing our full time staff, which was required to build the support structure necessary for the anticipated increase in sales volume in fiscal 1998.

Marketing and selling

These expenditures most clearly delineate the change in focus over the last year. The marketing expenses increased 363% over last year to $1,494,000 and selling expenses increased by 24% to $903,000.

With the launch of Nereus™ at COMDEX in November, significant expenditures were incurred to develop a market image for the Nereus™ system. Following COMDEX, the Company continued with an intensive marketing campaign, including direct mail, trade shows, trade magazine advertising, and networking with major industry players. Sales people experienced in specific vertical markets have been hired in order to achieve rapid market penetration.

Research and development

Research and development expenditures are considerably lower than the prior year because Smart Cata/og™ and SAFE-T-Disc™ reached commercial feasibility at the end of last year. These products incurred ongoing development costs related to maintenance and feature enhancements. Research and development expenditures continue on the Nereus™ product as the Company moves forward with product commercialization.

The Company continues its conservative accounting policies in preparing its financial statements. No development costs were capitalized in prior years. Nereus™ reached commercial feasibility at the end of fiscal 1997; consequently, the Company has not deferred any development costs to date.

Continuous development will be ongoing as the Company continues its transition to a software product company while maintaining its market position as a service company. This commitment is reflected in the change in reporting format that now includes research and development expenses as part of ongoing operations.

Liquidity and Capital Resources

The Company raised $9,474,000 through a special warrant offering this past year and an additional $36,000 from the exercise of stock options. Subsequent to the receipt of proceeds from the warrant issue, the Company extinguished its operating line of credit. Cash and short term investments on hand of $6,200,000 should be sufficient to fund the operations, debt retirements, and capital purchases for the coming year.

The Company is also currently evaluating alternative capital sources to fund the operating requirements beyond the current fiscal year.

Risks and Uncertainties

The Company is subject to the risks normally associated with the operation of a software product development and production service business. The Company must ensure that adequate systems and resources are available to respond to competitor aggression or market demands.

The success of the Company is, and will always be, dependent on its ability to retain strong management and skilled personnel. The loss of such personnel could negatively affect the Company.

Service revenues are highly dependent on the Alberta economy, and more particularly to the Edmonton and Calgary markets. The number of competitors in each of these markets is very high. Vicom distinguishes itself in these markets by being one of the largest players in the local markets. Price sensitivity is always an issue on smaller production service contracts. The Company's market niche is in the higher volume production projects where its eighteen years of experience are seen as a strong competitive edge.

There are a number of risks associated with the development and marketing of technology-based products such as those marketed by the Company. The multimedia market is relatively new and technology is changing rapidly. The Internet and the World Wide Web have, and will continue to have, impact on the multimedia market.

While industry experts such as The Gartner Group and Seybold Publications have validated the Company's core technology, there is a risk that new competitive products may prove superior in product design. Although the Company has taken the necessary precautions to protect its intellectual property, it may be possible to imitate, copy, or otherwise obtain its intellectual property. Outside of North America and Western Europe, effective protection of intellectual property may be limited.

High-end enabling technology does not itself guarantee success of a product. Market presence and market perception play essential roles in the success of any software product. Vicom is a new player in the software industry, and many companies are cautious when dealing with what may be perceived as an "upstart" in the software business. Many small software companies are faced with the issue of whether prospective purchasers are prepared to make a large investment in technology from a company with no record of accomplishment in the software arena. Vicom is addressing these issues and risks by hiring experienced software people, and creating sales and marketing strategies to minimize such concerns.

Outlook

The following statements reflect management's expectations for the Company, given the unique economic circumstances and associated risks inherent to companies involved in the development of high technology. As with any discussion of forward looking matters, actual results may vary from those outlined below.

In the late fall of 1996, Vicom announced a strategic partnership alliance with Oracle Corporation. The two companies are collaborating to integrate the Nereus™ technology into the Oracle® Universal Server and the Oracle® Video Server. The Company is progressing with that integration and is optimistic that this alliance will extend to a broader based relationship.

Multimedia is becoming a central part of business and industry worldwide. The growth potential offered to successful multimedia software products remains very large. Management believes that the Nereus™ technology is well poised in this class of software products.

The Staff, Management, and Board of Directors of Vicom Multimedia Inc. believe the Company has tremendous opportunity and potential. It is their responsibility to ensure that the Company capitalizes on those opportunities.

Management's Report

The consolidated financial statements of Vicom Multimedia Inc. were prepared by Management in accordance with accounting principles generally accepted in Canada. The financial and operating information presented in this annual report is consistent with those financial statements.

Management has designed and maintains a system of internal controls to provide reasonable assurance that the Company's assets are safeguarded and to faciliate the preparation of financial statements for reporting purposes.

KPMG, as the external auditors appointed by the shareholders, have conducted an independent examination in order to express their opinion on the consolidated financial statements. These financial statements have been approved by the Board of Directors on the recommendation of the Audit Committee.

Paul H. Braconnier
Chief Financial Officer

Auditors' Report to the Shareholders

We have audited the consolidated balance sheets of Vicom Multimedia Inc. as at January 31, 1997 and 1996 and the consolidated statements of operations and deficit and changes in financial position for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Company as at January 31, 1997 and 1996 and the results of its operations and the changes in its financial position for the years then ended in accordance with generally accepted accounting principles.

KPMG

Chartered Accountants
Edmonton, Canada

March 21, 1997

Consolidated Balance Sheets
January 31, 1997, and 1996

	1997	1996
Assets		
Current assets:		
Cash and short-term investments	$ 6,278,020	$ 244,101
Accounts receivable and accrued revenue	1,396,476	1,303,025
Work-in-progress, at cost	16,739	15,287
Prepaid expenses and deposits	158,641	65,808
	7,849,876	1,628,221
Capital assets, net of amortization (note 2)	2,195,501	1,773,204
Advances to joint venture (note 3)	315,921	—
Goodwill (note 3)	241,068	—
	$ 10,602,366	$ 3,401,425
Liabilities and Shareholders' Equity		
Current liabilities:		
Accounts payable and accrued liabilities	$ 1,119,157	$ 544,046
Production advances	—	679,822
Current portion of long-term debt (note 4)	304,448	—
Capital lease obligation	50,964	—
	1,474,569	1,223,868
Long-term debt (note 4)	619,484	414,955
Shareholders' equity:		
Share capital (note 5)	14,292,182	4,782,397
Deficit	(5,783,869)	(3,019,795)
	8,508,313	1,762,602
Commitments and contingencies (note 6)		
	$ 10,602,366	$ 3,401,425

See accompanying notes to consolidated financial statements.

On behalf of the Board:

Dale Hardy

Director

Director

Consolidated Statements of Operations and Deficit
Years ended January 31, 1997 and 1996

	1997	1996
Revenue	$ 6,008,363	$ 5,060,408
Production costs	3,216,959	2,700,757
Gross profit	2,791,404	2,359,651
Interest income	246,962	40,082
Expenses:		
General and administration	1,740,315	931,156
Marketing	1,494,282	322,719
Selling	903,081	730,722
Amortization	405,132	383,786
Interest on capital lease obligation	3,043	—
Research and development (note 7)	1,256,587	2,447,390
	5,802,440	4,815,773
Loss for the year	(2,764,074)	(2,416,040)
Deficit, beginning of year	(3,019,795)	(603,755)
Deficit, end of year	$ (5,783,869)	$ (3,019,795)
Loss per share	$ (0.173)	$ (0.179)

See accompanying notes to consolidated financial statements.

Consolidated Statements of Changes in Financial Position

Years ended January 31, 1997 and 1996

		1997		1996
Cash provided by (used in):				
Operations:				
Loss for the year	$	(2,764,074)	$	(2,416,040)
Items which do not involve cash:				
Amortization		405,132		383,786
Loss (gain) on disposal of capital assets		6,188		(10,088)
Change in non-cash operating working capital:				
Accounts receivable and accrued revenue		(118,279)		(623,974)
Work-in-progress		(1,452)		11,054
Investment tax credits receivable		—		60,899
Prepaid expenses and deposits		(92,833)		(30,820)
Accounts payable and accrued liabilities		416,524		67,038
Production advances		(679,822)		602,842
		(2,828,616)		(1,955,303)
Financing:				
Proceeds of long-term debt		285,045		414,955
Repayments of capital lease obligation		(20,350)		(3,800)
Increase in capital lease obligation		42,580		—
Net proceeds from issue of shares		9,509,785		164,000
		9,817,060		575,155
Investments:				
Additions to capital assets		(673,333)		(482,580)
Proceeds on disposal of capital assets		13,233		12,512
Increase (decrease) in accounts payable and accrued liabilities relating to capital asset additions		17,455		(224,000)
Advances to joint venture (note 3)		(311,880)		—
		(954,525)		(694,068)
Increase (decrease) in cash		6,033,919		(2,074,216)
Cash and short-term investments, beginning of year		244,101		2,318,317
Cash and short-term investments, end of year	$	6,278,020	$	244,101

See accompanying notes to consolidated financial statements.

Notes to Consolidated Financial Statements
Years ended January 31, 1997 and 1996

The Company is engaged in multimedia video and interactive communications and software development. The Company is subject to the provisions of the Business Corporations Act of Alberta and its shares are listed on the Alberta Stock Exchange.

1. SIGNIFICANT ACCOUNTING POLICIES:

(a) Basis of consolidation:

These consolidated financial statements include the accounts of the Company's wholly-owned subsidiary company incorporated in the United States. The subsidiary has no significant activities, assets or liabilities. These financial statements also reflect the Company's 50% proportionate interest in a joint venture, Datacat International, Inc., a United States company.

(b) Goodwill:

Goodwill represents the Company's proportionate share in the goodwill recorded by its joint venture, at the time of the joint venture partners' contributions to the joint venture on January 1, 1997. Goodwill represents the excess consideration paid over the fair value of net identifiable assets contributed, and is being amortized on the straight-line basis over three years. On an ongoing basis, management reviews the valuation and amortization of goodwill, taking into consideration any events and circumstances which might have impaired the fair value. Goodwill is written down to fair value when declines in value are considered to be other than temporary based upon expected cash flows of the joint venture.

(c) Capital assets:

Capital assets are stated at cost. Amortization is provided using rates sufficient to amortize the costs over the estimated useful lives of the assets. The methods and annual rates of amortization used are as follows:

Asset	Method	Rate
Production equipment	Declining balance	20%
Leasehold improvements	Straight-line	Lease term
Office furnishings and equipment	Declining balance	20%
Automotive equipment	Declining balance	30%
Computer software	Declining balance	50%

(d) Research and development costs:

The Company expenses research expenditures. Program and software development costs are expensed as incurred unless they meet generally accepted accounting criteria for deferral. The Company applies a stringent interpretation of the criteria. The Company reassesses whether each major project has met the relevant criteria on a quarterly basis. Research and development costs are reduced by the related government assistance, tax incentives and related revenues.

Amortization of deferred costs is calculated utilizing the straight-line method over the remaining economic life of the product, such a period not exceeding three years. Amortization commences once the product has achieved commercial acceptance.

(e) Revenue recognition:

Sales of software products are recognized when the product is delivered to the customer. Revenue from the sale of customized software packages, including implementation and installation services, is recognized on the percentage-of-completion basis. Fees from support

agreements for software packages are initially recorded as deferred revenue and recognized as revenue over the terms of the agreements.

Software license fees are recognized as revenue upon the fulfillment of all significant obligations under the terms of the license agreements.

(f) Foreign currency translation:
The consolidated financial statements are prepared using Canadian dollars. All operations whose principal economic activities are undertaken in currencies other than Canadian dollars have been determined to be self-sustaining.

The assets and liabilities of non-Canadian operations are translated at fiscal year end exchange rates and the resulting unrealized exchange gains or losses are accumulated as a separate component of shareholders' equity. The income statements of such operations are translated at exchange rates prevailing during the fiscal year.

Other monetary assets and liabilities which are denominated in foreign currencies are translated to the local currency at fiscal year end exchange rates, and transactions included in earnings are translated at rates prevailing during the fiscal year. Exchange gains and losses resulting from the translation of these amounts are included in the consolidated statements of operations.

(g) Use of accounting estimates:
The preparation of financial statements in conformity with generally accepted accounting principles requires the Company's management to make estimates that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities as at the date of the financial statements and the reported amounts of revenues and expenses during the reporting periods presented. Actual results could differ from the estimates made by management.

2. CAPITAL ASSETS:

	1997		
	Cost	Accumulated amortization	Net book value
Production equipment	$ 2,697,394	$ 1,511,747	$ 1,185,647
Leasehold improvements	502,908	190,687	312,221
Office furnishings and equipment	760,078	312,703	447,375
Automotive equipment	51,292	14,952	36,340
Computer software	325,626	111,708	213,918
	$ 4,337,298	$ 2,141,797	$ 2,195,501

Included in production equipment is equipment under capital lease with a cost of $42,580, accumulated amortization of $8,516, and a net book value of $34,064. Amortization of property under capital leases of $8,516 is included in amortization expense.

Also included in the cost of production equipment is $33,540 representing the Company's 50% proportionate share of equipment under capital lease acquired by its joint venture enterprise on January 1, 1997.

	1996		
	Cost	Accumulated amortization	Net book value
Production equipment	$ 2,326,428	$ 1,282,879	$ 1,043,549
Leasehold improvements	411,218	142,459	268,759
Office furnishings and equipment	588,362	240,482	347,880
Automotive equipment	24,117	8,170	15,947
Computer software	167,060	69,991	97,069
	$ 3,517,185	$ 1,743,981	$ 1,773,204

3. **ADVANCES TO JOINT VENTURE:**

During the year, the Company and an unrelated entity, DCI Holdings Inc. ("DCI"), entered into an agreement to establish a joint venture. The joint venture was incorporated as Datacat International, Inc. (the "joint venture") in the United States.

The joint venture was established effective January 1, 1997, with contributions of assets by the venturers in exchange for a 50% interest and other consideration for each of the Company and DCI. In exchange for assets contributed by the Company, which included the rights to the Smart Cata/og software developed by the Company and the accounts receivable, accounts payable, and capital assets related to this software, the Company received consideration of 2,000,000 common shares of Datacat International, Inc. with par value of $0.001 per share, representing a 50% interest in the joint venture. In addition, the Company received a promissory note receivable of $1,000,000 US, bearing interest at 3% per annum, becoming payable upon the earlier of a successful initial public offering of the joint venture, the date upon which cumulative net income of the $2,000,000 US is achieved by the joint venture, and December 31, 1999. At that time the note is repayable by the joint venture in 12 monthly installments.

The contribution of these assets has been reflected in these financial statements at the Company's share of the original carrying value, and no gain will be recognized until such time as the joint venture commences repayment of the promissory note.

To January 31, 1997, the excess of the Company's funding over its proportionate share of the joint venture's assets was $315,921. This includes $311,880 of working capital advances. These working capital advances bear interest at 3% per annum to a maximum of $625,000 US. Advances thereafter, if any, would be at prevailing market rates. The advances are due on demand once working capital of the joint venture exceeds $200,000 US and mature January, 1999.

The fiscal year end of the joint venture is December 31. The joint venture had no significant operations to January 31, 1997, and no activity is reflected in the consolidated statement of operations. The Company's 50% proportionate share of the joint venture's assets and liabilities, as at January 1, 1997, is as follows:

Assets:		
Current assets	$	82,929
Capital assets		868,595
Goodwill		242,456
	$	1,193,980
Liabilities and equity:		
Current liabilities		272,921
Long-term debt		223,932
Note payable to the Company		694,350
Share capital		2,777
	$	1,193,980

The following amounts have been included in the consolidated financial statements on consolidation of the joint venture:

Cash applied to establishment of the joint venture:		
Decrease in accounts receivable		24,828
Increase in accounts payable and accrued liabilities		169,867
Increase in capital assets		(173,518)
Increase in goodwill		(241,068)
Increase in long-term debt		223,932
Increase in investment in and advances to joint venture		(315,921)
	$	(311,880)

4. LONG-TERM DEBT:

	January 31, 1997		
	Face Value	Imputed Interest	Discounted Value
Interest free loan	$ 700,000	$ 101,920	$ 598,080
Current portion of interest free loan	304,448	27,185	277,263
	395,552	$ 74,735	$ 320,817
Obligation under special employment agreements	223,932		
	$ 619,484		

	January 31, 1996		
	Face Value	Imputed Interest	Discounted Value
Interest free loan	$ 414,955	$ 81,075	$ 333,880
Current portion of interest free loan	—	—	—
Long-term portion	$ 414,955	$ 81,075	$ 333,880

(a) Interest free loan:

The Company has an interest-free loan from the Government of Canada, Department of Western Economic Diversification, to assist with the development of the Company's proprietary products. Although unsecured, the Company cannot sell the rights to the related technology without the lender's consent.

The interest-free loan is a financial instrument and has been presented at a discounted value, along with a deferred imputed interest amount. The discounted value results from the calculation of the present value of the loan repayments at an imputed interest rate of prime rate plus 3%. The imputed interest has been deferred and will be amortized to operations over the term of the loan. On this same basis the imputed interest will be charged to operations.

As a result of the sale of a product whose development was funded in part by the interest-free loan, the Company must repay $106,672 within 15 days of written notice from the Department of Western Economic Diversification. It is expected that written notice will be received in April, 1997. The balance of the loan is repayable in six equal quarterly instalments commencing August 31, 1997. Interest will be charged on any late payments at the Bank of Canada lending rate plus 3%.

(b) Obligation under special employment agreements:

Pursuant to special employment agreements entered into by the Company's joint venture enterprise the Company is liable for its proportionate share of the joint venture's obligation to pay compensation to certain employees. The Company's 50% share of the obligation is $223,932. The obligation bears interest at 3% per annum, and becomes payable upon the earlier of a successful initial public offering of the joint venture, the date upon which cumulative net income of $2,000,000 US is achieved by the joint venture, and December 31, 1999. At that time the obligation is payable by the joint venture in 12 monthly installments.

The fair value of the obligation is $208,786 and represents the present value of contractual future payments of principal and interest assuming payments will commence on December 31, 1999, discounted at the current market rates of interest available to the Company for similar debt instruments.

(c) Future repayments:

Annual repayments are as follows, assuming the repayments of the obligation under the special employment agreements will commence December 31, 1999:

Fiscal 1998	$	304,448
Fiscal 1999		395,552
Fiscal 2000		37,322
Fiscal 2001		186,610
	$	923,932

5. Share capital:

	1997	1996
Authorized in unlimited numbers:		
Class A and B voting common shares		
Class C and D non-voting common shares		
Class P-1 preferred shares		
Issued:		
18,309,487 Class A shares (1996 - 13,673,500 shares)	$ 14,292,182	$ 4,782,397

(a) Share issues:

During the year ended January 31, 1996, the Company issued 200,000 Class A shares for cash consideration of $200,000 before share issue costs.

During the year ended January 31, 1997, the following share transactions occurred:

(i) The Company issued 35,987 Class A shares pursuant to its stock option plan for cash proceeds of $35,987.

(ii) Pursuant to a special warrant indenture dated May 7, 1996, the Company distributed 4,600,000 Special Warrants at a price of $2.25 per Special Warrant. Each Special Warrant entitled the holder, upon exercise and without payment of further consideration, to acquire one common share of the Company. By January 31, 1997, all of the Special Warrants had been exercised and 4,600,000 common shares were issued and distributed for net cash proceeds of $9,473,798.

b) Stock options:

(i) The Company granted to the agents of the Special Warrant financing non-assignable warrants, exercisable without payment of any additional consideration at any time, to acquire up to 230,000 share purchase options. Each option entitles the agents to acquire, on or before May 7, 1998, one Class A share of the Company at an exercise price of $2.25 per option.

(ii) The Company has reserved up to 10% of the issued and outstanding shares for issuance of options under its stock option plan. To January 31, 1997, the Company has granted options for the purchase of 1,606,413 Class A shares to its employees, directors and consultants as follows:

Number of shares	Exercise Price	Expiry date
3,900 shares	$1.00	February, 1997
1,046,613 shares	$1.00	September, 1999
126,900 shares	$1.00	November, 1999 to January, 2001
363,000 shares	$1.80	August, 2001
66,000 shares	$1.80	October, 2001

6. **Commitments and contingencies:**

(a) The Company is committed to the following minimum annual rental payments under operating lease agreements for office equipment, vehicles, and premises:

1998	$	135,553
1999		126,296
2000		61,579
	$	323,428

(b) In general, liabilities of the joint venture are secured by pledges of the related assets. At times, the joint venture participants may be required to further support these obligations should the realization from joint venture assets not be sufficient. To January 31, 1997, there are no further commitments and contingencies.

7. **Research and development:**

Costs related to product research, and product development costs which do not meet the Company's criteria for deferral, have been expensed in the Company's statement of operations. These costs include direct expenses for research, product development, market development and an allocation of overhead expenses.

	1997	1996
Total research and development expenditures	$ 1,505,382	$ 2,937,529
Less National Research Council funding	(191,175)	(18,825)
Less revenue earned on these projects	—	(424,880)
Less amortization of capital assets used in research and development activities, included in these financial statements in amortization expense	(57,620)	(46,434)
	$ 1,256,587	$ 2,447,390

In fiscal 1996, the National Research Council authorized a $210,000 grant for research and development for the period December 1, 1995 to January 31, 1997. Accounts receivable at January 31, 1997, includes $50,150 relating to this assistance (1996 - $18,825). Subsequent to year end, the National Research Council approved additional funding of $17,745 and extended the completion date to June 7, 1997. The conditions of the grant require the related research and development project be carried out in Canada.

8. **Income taxes:**

The expected effective tax rate for an Alberta public company is approximately 44%. The Company incurred a loss before income taxes in fiscal 1997. No recovery of prior years' taxes is available and no tax benefit of the loss has been recognized in these financial statements.

The Company has non-capital losses for income tax purposes of approximately $4,782,000 (1996 - $2,482,000) which may be carried forward to reduce future years' taxable income. These losses expire as follows:

1998	$ 1,000
1999	7,000
2000	3,000
2001	93,000
2002	890,000
2003	1,488,000
2004	2,300,000

As of January 31, 1997, the Company has approximately $350,000 (1996 - $269,000) of unutilized investment tax credits available for income tax purposes. These credits may be used to reduce future federal taxes payable. These credits expire between the years 2003 and 2007.

In addition, the Company has deductions available for income tax purposes in excess of those claimed for accounting purposes in the amount of approximately $980,000 (1996 - $720,000).

The potential benefits of the losses carried forward, the unrecorded investment tax credits and the additional income tax deductions available have not been recognized in these financial statements.

9. Financial instruments:

(a) Fair values:

The carrying values of cash and short-term investments, accounts receivable and accrued revenue, accounts payable and accrued liabilities and the capital lease obligation approximate their fair values due to the relatively short periods to maturity of the instruments. The fair value of long-term debt is disclosed in note 4 to these financial statements.

The fair value of the advances to the joint venture is not significantly different from its carrying value.

(b) Credit risk:

Included in accounts receivable at January 31, 1997, is $360,335 due from a customer which is controlled by a minority shareholder. Management considers the amount to be fully collectible.

10. Statement of Operations Information:

				Geographic		
1997	Software products	Service	Total	Canadian	Foreign	Total
Sales	21.5%	78.5%	100.0%	82.2%	17.8%	100.0%
Gross margin as a % of Sales	74.5%	39.4%	46.5%	40.7%	73.0%	46.5%
1996						
Sales	11.5%	88.5%	100.0%	94.4%	5.6%	100.0%
Gross margin as a % of Sales	72.2%	43.3%	46.6%	45.2%	71.5%	46.6%

Corporate Information

Management & Directors:

Daniel Chugg, *Chairman of the Board*
President & Chief Executive Officer
Vicom Multimedia Inc.
Edmonton, Alberta

Michael Lang, *Director*
Chief Financial Officer
Beau Canada Exploration Ltd.
Calgary, Alberta

William DeJong, *Director*
Partner, Ballem MacInnes
Calgary, Alberta

Barry Chugg, *Director*
Vice President
Vicom Multimedia Inc.
Calgary, Alberta

Dale Hardy, *Director*
Senior Vice President
Vicom Multimedia Inc.
Edmonton, Alberta

Paul Braconnier, *Chief Financial Officer*
Chief Operating Officer
Vicom Multimedia Inc.
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Michael Lightheart
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Legal Counsel

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Bankers

Alberta Treasury Branches
Edmonton, Alberta

Registrar and Transfer Agent

R M Trust Company
Calgary, Alberta

Stock Exchange Listing

The Alberta Stock Exchange
Trading Symbol: VMI

Annual Meeting

The Annual meeting of Shareholders of Vicom Multimedia Inc. will be held at 10:00 a.m. on Tuesday, June 24, 1997, in the Mayfield Inn, 16615 - 109 Avenue, Edmonton, Alberta.

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